



Illinois Power Agency  
Draft 2012 Procurement Plan  
Comments of Iberdrola Renewables, Inc.

September 15, 2012

### Introduction

Iberdrola Renewables, Inc. (“IRI”) is a renewable energy developer, owner, and operator headquartered in Portland, Oregon. The company also owns and operates natural gas storage in North America and thermal generation in Oregon. IRI owns and operates over 4,600 MWs of wind farms in seventeen states and is developing solar and biomass projects. One of the company’s Midwest development offices is located in Palatine, IL. IRI owns and operates two Illinois wind farms, Providence Heights (72 MWs) in Bureau County and Streator Cayuga Ridge South (300 MWs) in Livingston County. IRI has won contracts in each Illinois Power Agency (“IPA”) one-year renewable energy credit (“REC”) auction and also successfully won two long-term contracts for the New Harvest Wind Farm in Iowa.

IRI thanks the IPA for the opportunity to provide these comments. As a renewable energy developer, owner, and operator our comments will be specific to the section of the plan which addresses renewable energy resource procurement.

## The Value of Long-Term Renewable Energy Resource Procurement

IRI provided comments on June 22, 2011 on the implementation of the 2011 IPA procurement of renewable energy resources. The comments highlighted the deficiencies of over-reliance on one-year REC procurements to meet the IPA's Renewable Portfolio Standard ("RPS") obligations. We commend the IPA for addressing this concern in the draft 2012 procurement plan ("the plan"). The plan proposes to "...invite bids for periods of up to 20 years from renewable generators (p. 50)."

However, the plan does not necessarily commit the IPA to making any long-term REC purchases. As a result, IRI will build on its comments submitted on the 2011 procurement to further demonstrate the value of long-term hedging strategies. IRI strongly encourages the IPA to build on the plan's invitation for bids up to 20 years and to transact on at least some of the long-term offers it receives.

IRI has conducted a study of the Illinois REC portfolio and cost caps from 2013 to 2024.<sup>1</sup> Our study revealed three key findings which bear directly on the IPA. First, both short-term and long-term REC prices have been falling and are below the level that would be required to support building new wind generation. This is due to excess merchant wind generating capacity scattered throughout the region and country. This presents an excellent opportunity for the IPA to lock in long-term RECs at potentially very favorable pricing. Second, energy commodity and REC prices are extremely volatile. While volatility can increase or decrease prices – REC prices are so low now that the risk to consumers is that both prices and consumer costs will rise. Our study estimates that the

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<sup>1</sup> IRI would be pleased to discuss the study's specifics in person with IPA and ICC staff at their request.

cost of securing the IPA wind portfolio from 2013 to 2014 could increase by as much as 20 percent if the IPA waits a year to lock in long-term REC contracts. A significant tax or regulatory change could dramatically increase prices and risk. Third, the IPA has room within its current cap structure to secure long-term contracts without running the risk of exceeding the cap. Collectively, these factors lead us to believe that it is in the IPA's interest to undertake a long-term hedging strategy for RPS compliance.

#### Eligible Long-Term Contract Suppliers

In order to reduce long-term contract default risk, we recommend that the IPA consider an eligibility requirement successfully used by PECO for its long-term (5-year) REC request for proposals ("RFP") in Pennsylvania. PECO's RFP required eligible offers to come from suppliers which either own, develop, or have generation assets under their control. This ensures that long-term suppliers have generation resources under their control capable of meeting their long-term contract obligations.

#### The IPA Should Solicit Standardized Term REC Products

The plan proposes to invite REC bids for periods of up to 20 years from renewable generators. However, there is no further detail in the plan regarding preferred terms or how REC bids of varying proposed lengths will be evaluated against each other. For example, how would the IPA determine the least-cost alternative from numerous bids of various lengths with one party offering say at 10-year term, another a 15-year term, and still another a 20-year term? The IPA selects REC bids based on least cost offers, but selecting prudent offers over the longer term requires different calculations of risk and the

value of contract length as a hedge, making direct price to price comparison for REC products of different terms difficult.

As a result, in order to compare apples to apples, IRI recommends that the IPA modify the plan to solicit long-term REC bids of fixed terms. Soliciting REC bids for one-year, five-year, and ten-year terms will address concerns regarding over-reliance on one-year contracts, while enabling the IPA to fairly compare REC prices for the least-cost offers per the different term REC products. The IPA would evaluate the cost-effectiveness of various bids within each REC product category (one-year, five-year, and ten-year) instead of across product categories.

#### Setting Benchmarks for Long-Term REC Products

In order to ensure cost-effectiveness in each REC product category the IPA will need to set different benchmark prices. For example, because the supply and demand dynamics, as well as the hedge value, will be different for each REC product category, simply using, for example, the benchmark established for one-year RECs will not provide sufficient information to determine the cost-effectiveness of five-year and ten-year offers. As a result, the IPA should set individual benchmarks for these products. This does raise a challenge for the IPA, since market information for five and ten year terms will not be available (at least not widely, and not at all for the specific Illinois market).

To establish benchmarks for the ten-year term, IRI recommends that the IPA perform an analysis of the likely incremental cost (the delta between expected wholesale energy costs, based on the IPA's forward energy curves and expected federal tax benefits, and the "all-in" price a new resource needs to be economic. This delta should represent a

prudent REC price to meet increasing RPS demand). In establishing the ten-year benchmark, the IPA should also consider that the benchmark price will need to be high enough to reflect the incremental cost of the last renewable resource that will need to come online to meet increasing RPS demand, otherwise full RPS compliance will be compromised.

Establishing the five year benchmark is potentially slightly more challenging as five year benchmark prices would likely be less informed by the incremental cost of new supply necessary to meet increasing RPS demand and more by short-term REC supply and demand. As a result, we would recommend a benchmark that uses a combination of the ten year benchmark and information on likely short-term REC supply and demand.

As demonstrated above, a “portfolio approach” to REC procurement will enable the IPA to achieve stable REC pricing, provide opportunities to take advantage of downturns in REC prices by maintaining a meaningful part of the portfolio in one-year purchases, while sending price signals necessary to encourage new development required to meet increasing RPS requirements.

IRI commends the IPA for considering “in-state” benefits in its benchmarks since local tax revenues, landowner lease payments, and local and regional economic development activity undoubtedly provide benefits to the state over and above the purchase of unbundled RECs from outside of Illinois. The New York State Energy Research Development Authority (“NYSERDA”) which is the New York RPS administrator and central REC purchasing authority makes similar considerations in its procurement and seeks to balance in-state development value and REC prices. Using this

approach in Illinois will provide more value for money for Illinois's eligible electricity customers.

#### “Energy-Only” Offer Opportunities for Renewables

A meaningful portion of revenue for renewable energy projects are derived from energy sales. The 2010 long-term contracting procurement recognized this and sought offers for energy and RECs (bundled contracts). The 2008, 2009, and 2011 procurements and the 2012 procurement plan do not envision opportunities for renewable energy projects to offer energy to the IPA. In order to provide both a more robust renewable energy market and to encourage renewables to make offers on a basis similar to conventional resources, IRI recommends that the IPA consider purchasing 5-year flat “around-the-clock” blocks of energy in increments of 25 MW or less, in addition to its current 3-year on-peak/off-peak procurements. While this structure does not guarantee broad participation from renewable energy projects, this could allow renewables to play an incrementally more active role in supplying default-service load by providing for a longer-term hedge against price volatility.

#### A Note on Bundled Long-Term Energy Contracts

The 2010 IPA Procurement Plan included the procurement of twenty-year, bundled renewable energy contracts. The 2012 plan refers to these contracts and notes that the IPA is not counting any of the energy from these contracts as part of its energy supply. This may be causing some concern regarding wind energy's ability to provide energy for load. While not a core part of our comments, IRI wants to point out that wind energy, if the contracts are structured appropriately, can meet energy requirements, it just turns out that

the 2010 IPA bundled contracts were not structured in such a way. The above recommendation for IPA to consider purchasing 5-year flat “around-the-clock” blocks of energy is one such structure that can facilitate this. There are other structures in use across the country which have enabled counterparties to use renewable energy to meet load requirements. IRI would be pleased to discuss such contracting structures further with the IPA.

In the future, should the IPA seek to acquire additional bundled renewable energy contracts, IRI can provide the IPA with examples of other contracts which have enabled the buyer to use energy to meet its load obligations.

#### Conclusion

IRI thanks the IPA for the opportunity to provide these comments. Please contact Eric Thumma at 484-654-1887 or [ethumma@iberdrolaren.com](mailto:ethumma@iberdrolaren.com) should you wish to discuss further.

Respectfully Submitted,



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Eric Thumma  
Director, Institutional Relations  
Institutional Relations